

IT 99-6

Tax Type: Income Tax

Issue: Unitary – Inclusion of Company(ies) In A Unitary Group

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS,
Petitioner**

v.

**"GLAMOUR GAL, INC.",
Taxpayer**

No. 96-IT-0000

**Linda K. Brongel,
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Fred O. Marcus of Horwood, Marcus & Berk Chartered and James Spira, for taxpayer, "Glamour Gal, Inc."; Sean Cullinan, Special Assistant Attorney General, for the Department of Revenue.

SYNOPSIS:

This case involves "Glamour Gal, Inc." ("GG" or "taxpayer") and its subsidiaries for the tax years ending September 30, 19xx and September 30, 19xx. On January 31, 1996, the Department of Revenue issued a Notice of Deficiency against the taxpayer in the amount of \$487,777, including interest and penalties. This Notice of Deficiency also served as a Notice of Denial to the amended returns taxpayer filed which created two separate unitary groups: the "GG" group and the "Style & Smile" Beauty Company, Inc. group. "GG" timely protested this Notice of Deficiency on February 13, 1996.

The issue in this case is whether the Illinois Department of Revenue ("Department") correctly included certain subsidiaries of "GG" in a single unitary business group or whether taxpayer and its subsidiaries are properly included in two unitary groups.¹ A hearing was held on this matter March 1, 2, 3 and 9, 1999 where testimony was heard and documents submitted.²

Following the submission of all evidence and a review of the record, it is recommended that these issues be resolved in favor of the taxpayer in part, and in favor of the Department in part. In support thereof, the following findings of fact and conclusions of law are made:

FINDINGS OF FACT:

1. "Glamour Gal, Inc., is a manufacturer of health, beauty, household and food products located in "Someplace", Illinois. (Dept. Ex. Nos. 18, 19)
2. Taxpayer originally filed Illinois income tax returns for the tax years ended September 30, 19xx and September 30, 19xx on a combined basis with all of its subsidiaries which are subject to Illinois taxation. The companies included in those returns are: "Glamour Gal USA, Inc." ("GG-USA"), "Powder-Puff Services" ("Powder"), "GG International, Inc." ("International"), "Style & Smile" Beauty Co., Inc. ("Style"), "Care-a-Lot" Beauty Supply, Inc. ("CAL"), and "Johnny Velour" Beauty Systems, Inc. ("Johnny V."). (Dept. Ex. No. 2)
3. Taxpayer later filed amended returns on the basis of two separate unitary groups: One included "GG", "GG-USA", "Powder-Puff" and "International". The other group, the "Style &

¹ At the conclusion of the presentation of evidence taxpayer's counsel made a motion for a directed finding. I took taxpayer's motion under advisement, and by this recommendation, a ruling on taxpayer's motion is unnecessary.

² For purposes of this recommendation, references to the hearing transcript of March 1 are cited as Tr. vol. 1, , references to the hearing transcript of March 2 are cited as Tr. vol. 2, , references to the hearing transcript of March 3 are cited as Tr. vol. 3, and references to the hearing transcript of March 9 are cited as Tr. vol. 4.

Smile" group," included "Style & Smile", "Care-a-Lot", "Johnny V." and "Beauty Is Us Co." ("BIU"). (Dept. Ex. Nos. 23 through 26)

4. At hearing, taxpayer conceded that "BIU" was properly part of the "GG" unitary group and should not have been made a part of the "Style & Smile" unitary group claim. (Tr. vol. 4, p. 11)

5. "Style & Smile" was incorporated in 1964 and its stock was purchased by "GG" in 1969. (Tr. vol. 1, p. 135; Tr. vol. 3, p. 9) "Style & Smile" is a retailer selling beauty supplies operating over 1000 stores throughout the United States. (Dept. Ex. No. 19)

6. "Style & Smile's" corporate headquarters are in "Bullhorn", Texas. Neither "GG", "GG-USA" nor "International" share any facilities or warehouse space with "Style & Smile". (Tr. vol. 3, p. 63)

7. "GG" and "GG-USA" share corporate headquarters in "Someplace", IL. Neither "GG" nor "GG-USA" share these facilities with "Style & Smile". (Tr. vol. 3, p. 15)

8. "Style & Smile" sells professional beauty supplies to beauty salons and to the general public. (Tr. vol. 1, p. 135)

9. "Style & Smile's" primary suppliers are "Younger-You Corp.", "Nip & Tuck Co.", "Sell-U-Lite, Inc.", "Lushious Lipps Co.", and "Blow-Dry" professional division. "Style & Smile's" primary suppliers are competitors of "GG-USA". (Tr. vol. 1, p. 141)

10. "GG-USA" is not a primary supplier, although it is a major supplier to "Style & Smile". "Style & Smile" buys shampoo, conditioners, styling aids and various other hair care products from "GG-USA". "GG-USA's" products are meant for consumer use, while some of "Style & Smile's" products are meant for professional use, such as shampoo concentrate. "Style & Smile's" purchases of product from "GG-USA" were approximately 3 percent of its total

purchases in 1991 and 1992. "Style & Smile" sells over 4,000 different products, of those approximately 40 to 50 come from "GG". (Tr. vol. 1, pp. 141-144)

10. "Chuck Baree" ("Baree"), president of "Style & Smile", testified that it was difficult to get distribution rights from "GG's" competitors because "Style & Smile" was owned by "GG". (Tr. vol. 1, p. 142) "Style & Smile" does not give "GG" any special pricing arrangements or payment terms. (Tr. vol. 1, p. 150) Had "Style & Smile" given "GG" preferential treatment, the other vendors would not have let "Style & Smile" distribute their product. (Tr. vol. 1, p. 149)

11. "Style & Smile" owns 100 percent of the stock of "Johnny Velour Beauty Systems". "Johnny V." distributes beauty supplies to hair salons. "Johnny V." salesmen go directly to the hair salon and take orders. The products "Johnny V." sells are geared to salon usage and come from a different set of suppliers than "Style & Smile's" suppliers. "Johnny V.'s" suppliers are companies such as "Wrinkle-Smooth, Inc.", "Old-No-More Corp.", "Hair-So-Fine, Inc.", and "Brilliant Sheen International". "Johnny V." does not purchase products from "GG". (Tr. vol. 1, pp. 150-152)

12. "Johnny V." has its own accounting department, data processing department, credit and collection staff, distribution and shipping department, purchasing department, customer service staff, human resource department. "Johnny V." does not have its own legal department, accounts payable department, treasury department or cash management system. These services are provided to "Johnny V." by "Style & Smile". "GG" does not provide any of the above services to "Johnny V.". (Tr. vol. 1, pp. 153-155)

13. The corporate officers of "GG" are:

| | |
|-----------------|--|
| "Sue Preems" | Chairman and Chief Executive Officer |
| "Moe Zart" | President and Chief Operating Officer |
| "Abby Rohd" | Executive Vice President and Asst. Secretary |
| "John B. Goode" | Vice President, Finance-Controller |

| | |
|------------------|--|
| "Beau Jangels" | Vice President and General Counsel |
| "Peggy Soo" | Vice President, Secretary & Treasurer |
| "Sonny N. Shere" | Vice President, Research and Development |

(Dept. Ex. Nos. 18, 19)

16. The corporate officers of "GG-USA" are:

| | |
|-----------------------------------|--|
| "Sue Preems" | Chairman and Chief Executive Officer |
| "Moe Zart" | President and Chief Operating Officer |
| "Abby Rohd" | Executive Vice President, Marketing and Asst. Secretary |
| "Lou E. Loui" | Vice President, Professional Services Division |
| "Mary Alongcoms" | Vice President and Controller |
| "D. N. Warwick" | Vice President, Food Services |
| "Peggy Soo" | Vice President, Secretary and Treasurer |
| "Barb Buran" | Vice President, Advertising Services |
| "Dick C. Chix" | Vice President, Operations |
| "Simon Garfunkel" ³ | Vice President, Human Resources |
| "Rose Anna" | Vice President, Market Research |
| "John E. Angel" | Vice President, Information Services |
| "Georgia Brown" | Vice President, Household/Grocery Products Division |
| "L. Tenjohn" | Vice President, Marketing, Toiletries Division |
| "Mark A. Reyna" ⁴ | Vice President, Corporate Communications |
| "Bill E. Donbeahero" ⁵ | Vice President & General Manager, Toiletries Division |
| "Carmen Kameleon." ⁶ | Vice President, Personnel |
| "Dan E. Boye" | Group Vice President, Toiletries & Household/Grocery Products Division |

(Dept. Ex. Nos. 18, 19)

14. The corporate officers of "Style & Smile" are:

| | |
|------------------------|-------------------------------------|
| "Chuck Baree" | President |
| "Ted E. Bear" | Senior Vice President |
| "Peter N. Gordon" | Executive Vice President |
| "Billie Jo McAllister" | Executive Vice President |
| "Peggy Soo" | Vice President, Secretary/Treasurer |
| "Moe Zart" | Vice President |
| "Judy Indisgize" | Vice President |
| "Gary Indiana" | Vice President |
| "Harold Hill" | Vice President |

³ Per the 1992 annual report.

⁴ Per the 1992 annual report.

⁵ Per the 1991 annual report.

⁶ Per the 1991 annual report.

| | |
|-------------------|----------------|
| "Bennie Andajets" | Vice President |
| "George E. Gerl" | Vice President |
| "Henry Theeaith" | Vice President |
| "Floyd Pinke" | Vice President |
| "Ima Walken" | Vice President |
| "L. Avida Loca" | Vice President |

(Dept. Ex. No. 14)

17. "Sue Preems", the founder and president of "GG" is the Chairman of the Board of "Style & Smile". (Dept. Ex. No. 14, p. 4) Neither she, "Moe Zart" or "Peggy Soo" who are common officers of "Style & Smile" and "GG" are involved in the day-to-day operations of "Style & Smile", nor are they involved in the formulation and implementation of major policy decisions.

Their titles are ceremonial in nature. (Tr. vol. 1, pp. 161-165; 190)

15. "Chuck Baree" has been the president of "Style & Smile" for 27 years. He has never been an officer of either "GG" or "GG-USA". (Tr. vol. 1, p. 129) "Baree" has a high degree of independence in running "Style & Smile". (Tr. vol. 3, p. 82)

16. Long-term strategic goals are formulated by "Style & Smile's" senior management: "Chuck Baree", "Billie Jo McAllister", "Peter N. Gordon" and, in part, "Gary Indiana". "McAllister", "Gordon" and "Indiana" have never been employees of "GG" or "GG-USA". (Tr. vol. 1, pp. 156; 164-168)

17. "Style & Smile's" senior management approves contracts without review by "GG". (Tr. vol. 1, pp. 168; 185)

18. Day-to-day operations of "Style & Smile" are directed by "Style & Smile's" senior management. "GG" has no involvement in "Style & Smile's" day-to-day operations. (Tr. vol. 1, p. 158)

19. "Style & Smile" sets its own prices. "GG" or "GG-USA" do not review them. (Tr. vol. 1, p. 185)

20. "Style & Smile's" financial group prepares its budget which is reviewed and approved by "Style & Smile" senior management. These budgets are then submitted to "GG" for review. In 27 years, "Style & Smile's" internally-prepared budget has never been rejected by "GG". (Tr. vol. 1, pp. 165-166)
21. "Baree" makes informational reports to the president of "GG", Mr. "Zart", approximately once a month, and they meet in person approximately 8 or 9 times per year. (Tr. vol. 1, p. 159)
22. "Style & Smile" has its own legal department. It is responsible for lease negotiations, acquisitions, EEOC matters, and lawsuits involving "Style & Smile". Major settlements require the approval of "Peter N. Gordon", Executive VP of "Style & Smile". "Style & Smile" hires its own outside counsel. "Style & Smile" is not required to receive approval from "GG" when it retains outside counsel. (Tr. vol. 2, pp. 11-14)
23. Intercompany charges for legal services relate to instances where "GG", as the parent corporation, is also named in a lawsuit involving "Style & Smile". (Tr. vol. 2, pp. 15-16)
24. "Style & Smile" owns or leases its own distribution centers. None of "Style & Smile's" distribution centers are shared with any other "GG" affiliate. (Tr. vol. 1, pp. 184-185)
25. "Style & Smile" has its own distribution department. The distribution department receives all product purchases, warehouses it and distributes it to the stores. (Tr. vol. 2, p. 17)
- "Style & Smile's" distribution department performs no services for "GG-USA" nor does "GG-USA's" distribution department perform services for "Style & Smile". The head of the distribution department does not report to anyone at "GG" or "GG-USA". (Tr. vol. 2, pp. 18-19)
26. "Style & Smile" has its own personnel department. "Style & Smile's" personnel department is responsible for hiring and firing its own employees and administering employee benefit programs. (Tr. vol. 2, p. 19) "Style & Smile's" head of personnel reports to Mr.

"Gordon" of "Style & Smile". "Style & Smile" does not need to approval from "GG" or "GG-USA" on personnel issues. (Tr. vol. 2, pp. 22-23) "Style & Smile" has its own employee handbook. (Tr. vol. 2, p. 23)

27. There is no employee transfer program between "GG" or "GG-USA" and "Style & Smile". The only employee transferred between "GG" and "Style & Smile" was "Floyd Pinke" in the personnel department. He went through the same hiring procedures as any other employee. "Style & Smile" does not seek out "GG" or "GG-USA" employees to fill job vacancies since "Style & Smile" is a retailer and they seek individuals with retail experience. (Tr. vol. 2, pp. 20; 23-24)

28. "Style & Smile" has its own loss prevention department, which is responsible for protecting the assets of the company from theft. The loss prevention department does not report to anyone at "GG" or "GG-USA". "Style & Smile's" loss prevention department provides services to "Style & Smile's" subsidiaries, but does not provide services for "GG" or "GG-USA", nor does "GG" provide loss prevention services to "Style & Smile". (Tr. vol. 2, pp. 24-26)

29. "Style & Smile" has its own advertising department. "Style & Smile's" principal method of advertising consists of a mailing to its customers. "Style & Smile's" merchandising group selects the products to be featured in the mailing, and the advertising group does the artwork and layout. It is then approved by "Style & Smile's" senior management and mailed. (Tr. vol. 1, pp. 173-174) Neither "Powder-Puff" nor "GG" performs any advertising services for "Style & Smile". (Tr. vol. 1, pp. 175-176) "Style & Smile" does not engage in joint advertising with "GG-USA". (Tr. vol. 1, p. 182) "Style & Smile" conducts its own market research. (Tr. vol. 1, p. 182)

30. "Style & Smile" has its own management information systems department ("MIS"). The responsibility of MIS is to develop and maintain the software necessary to gather the financial

information of the company. Nightly, information is gathered from each store regarding sales and deposits. MIS also provides support to the stores for point of sale terminals. "Style & Smile's" MIS department does not perform services for "GG" or "GG-USA". Neither "GG" nor "Style & Smile" can access the other's data processing systems. (Tr. vol. 2, pp. 27-30)

31. "Style & Smile" has its own finance department, which performs services for "Style & Smile" and its subsidiaries. "Style & Smile's" finance department does not perform services for "GG" and "GG-USA". The finance department prepares monthly financial statements for "Style & Smile's" management and "GG". The reports provided to "Style & Smile's" management are more detailed than the reports prepared for "GG's" management. The software used by "Style & Smile's" finance department is different from that used by "GG". (Tr. vol. 2, pp. 32-34) "Style & Smile" prepares the financial statements that it provides to "GG" so that "GG" can incorporate them into their financial statements for external reporting purposes. (Tr. vol. 2, pp. 77-78; vol. 3, p. 16)

32. "Style & Smile" has its own accounting department. "Style & Smile" maintains its own chart of accounts separate and apart from "GG" and "GG-USA". "Style & Smile" developed and maintains its own accounting manual. "GG" has its own accounting manual. (Tr. vol. 2, pp. 32-34)

33. "Style & Smile" has its own accounts payable department. The accounts payable department validates all receipts and processes invoices for payment. "Style & Smile's" accounts payable department performs services for "Style & Smile" and its subsidiaries. It performs no services for "GG" or "GG-USA", neither does "GG" or "GG-USA's" accounts payable department perform services for "Style & Smile". (Tr. vol. 2, pp. 39-40)

34. "Style & Smile" has its own cash management system. Cash is swept from "Style & Smile's" accounts on a daily basis and is invested in short-term investments. The investments are determined by "Style & Smile's" banking manager. "Style & Smile" and its subsidiaries participate in "Style & Smile's" cash management system. "GG" has its own distinct cash management system. The two systems are not integrated in any way. (Tr. vol. 2, pp. 34-36; Tr. vol. 3, p. 14)

35. In 1991 and 1992, "Style & Smile" retained the cash generated from operations and used it to open stores, make acquisitions and make capital expenditures. In 1991, "Style & Smile" funded a small acquisition with its own cash flow. "Style & Smile" also opened a distribution center in "Palooka", Ohio which was acquired with internal funds. "Style & Smile" opened an additional 200 stores during the period which were also funded internally. No cash was transferred from "Style & Smile" to "GG" during 1991 and 1992. (Tr. vol. 2, pp. 37-38)

36. "GG's" tax department prepares the federal consolidated return which includes "Style & Smile" as well as "Style & Smile's" state income tax returns. "GG" also prepares "Style & Smile's" state income tax returns using the same software and basic information as is used in preparing the federal. (Tr. vol. 2, pp. 114-115) Regarding "Style & Smile's" sales taxes, "GG" does not review "Style & Smile's" sales tax returns or handle their sales tax audits. (Tr. vol. 2, p. 117)

37. No loans were made to "Style & Smile" during 1991 and 1992 by "GG". (Tr. vol. 2, p. 67)

38. During 1991 and 1992 "Style & Smile" had an outstanding \$70,000,000 note with "GG" which represented a previous loan from "GG" to "Style & Smile" for funds to acquire "Grey B. Gone" Beauty Supply. (Tr. vol. 2, p. 85)

39. "GG" requires its employees to get the approval of the capital appropriations committee for expenditures over \$50. (Tr. vol. 3, p. 22) "Style & Smile" is required to get "GG's" approval for expenditures in excess of \$100,000, although "Style & Smile" is not required to get approval to open new stores, for which the cost is approximately \$100,000. (Tr. vol. 3, p. 11)

40. "Style & Smile" has its own internal audit staff. Their primary responsibility is to perform operational audits in the stores which entail determining whether policies and procedures, particularly as to handling cash, are being followed. "Style & Smile's" internal audit staff perform no audits of "GG" or "GG-USA". "GG" has its own internal audit staff and one of its duties is to perform audits of "Style & Smile" to validate the financial information "Style & Smile" transmits to "GG". "GG's" internal audit staff is not involved in the internal audits performed by "Style & Smile". (Tr. vol. 2, pp. 40-41)

41. "Style & Smile" has a credit and collection department which oversees accounts receivable of "Style & Smile" and its subsidiaries. The credit and collection department performs no services for "GG" or "GG-USA". (Tr. vol. 2, p. 42)

42. "Accountants R Us" is the outside auditor for both "GG" and "Style & Smile". "ARU" prepares separate audit reports for "GG" and "Style & Smile". The purpose of having separate audit reports is so that "Style & Smile" maintain its own creditworthiness. (Tr. vol. 2, pp. 42-44; Taxpayer's Ex. No. 3)

43. "Style & Smile" has its own tax department. The tax department is responsible for preparing all sales tax reports, property tax filings, 1099's and escheat tax reports for "Style & Smile" and its subsidiaries. (Tr. vol. 2, pp. 45-46)

44. "Style & Smile" has its own real estate department. The real estate department finds store sites, negotiates leases, submits the leases to "Style & Smile's" real estate committee for

approval, and sees to all the requirements to open a store. No one from "GG" is on the real estate committee, nor does "Style & Smile" need "GG's" or "GG-USA's" approval to open stores. (Tr. vol. 2, pp. 47-50)

45. "Style & Smile" has its own training department which prepares management and store operational training for "Style & Smile" employees. "GG" is not involved in "Style & Smile's" training nor does "Style & Smile's" training department perform services for "GG" or "GG-USA". (Tr. vol. 2, pp. 52-54)

46. "Style & Smile" has its own insurance department. The insurance department administers all of "Style & Smile's" benefit programs, i.e., health insurance, life insurance and workers compensation insurance. "Style & Smile" is self-insured. It administers its own programs and pays its own claims. During 1991 and 1992 "Style & Smile" used Blue Cross-Blue Shield as the outside administrator of the health insurance program. (Tr. vol. 2, pp. 54-56) Although some of the carriers for the various plans were the same as the carriers for "GG's" plans, the plans are different due to the needs of "Style & Smile's" employees. "GG" and "Style & Smile" use the same plan administrator to achieve cost reductions. (Tr. vol. 2, pp. 57-59)

47. "GG" acts as "Style & Smile's" payroll processor. "Style & Smile's" payroll department processes the payroll input for all of "Style & Smile's" hourly employees and all of "Style & Smile's" executives. "Style & Smile's" payroll department gathers the information, inputs the data and transmits it to "GG". After it is processed in "GG's" payroll system, it comes back to "Style & Smile". "Style & Smile" actually writes the checks and distributes them. (Tr. vol. 2, pp. 105-106) "Peggy Soo" is the treasurer of both "GG" and "Style & Smile". "GG's" payroll department reports to her. Mr. "Gordon" speaks with her on a weekly basis to resolve any payroll discrepancies. (Tr. vol. 2, pp. 95-96)

48. "GG" pays "Baree" and bills his salary to "Style & Smile" in order to maintain the confidentiality of his pay. (Tr. vol. 1, pp. 198-199)
49. "GG" has a research and development department which develops products for "GG-USA" and International, but which performs no services for "Style & Smile". (Tr. vol. 3, p. 62)
50. "International" is a consumer products manufacturer and distributor. It distributes products outside the United States. Principally, International manufactures and markets the same products as "GG", such as the "Brilliant Cream" and "GG" brands, although there are some local brands which are marketed internationally. No one at "International" is involved in "Style & Smile's" business operations. (Tr. vol. 3, pp. 63-64)
51. "GG-USA" is a manufacturer and distributor of consumer products, food products, household products and toiletry products. "GG-USA" manufactures various products under the "Brilliant Cream" brand, such as shampoo and hairspray. Other brands are "Mrs. Doubtfire" No Fat Yogurt, "Slippery Guard Soaps", "Whoops", women's hygiene spray, "En Garde" shampoos and conditioners, "Oh So Sweet" sugar substitute, "Sparkle" furniture polish and various "GG" products. In total, "GG-USA" manufactures between 800 and 1500 different products. (Tr. vol. 3, pp. 65-66) Approximately 30 to 40 of these products are sold to "Style & Smile". (Tr. vol. 3, p. 69)
52. "GG-USA's" customers are primarily mass merchandisers, such as Wal-Mart, K-Mart and Target, food stores and drug stores. (Tr. vol. 3, pp. 66-67)
53. In 1991 and 1992, "GG-USA's" total sales were approximately \$300 million dollars. Of those sales, about 3 percent were to "Style & Smile" in 1991 and somewhat less than 3 percent in 1992. (Tr. vol. 3, p. 69)

54. "GG-USA" offers no special terms or discounts to "Style & Smile". In fact, "GG-USA's" biggest customers are competitors of "Style & Smile", and dislike the relationship between "GG-USA" and "Style & Smile", so that no special treatment is possible. (Tr. vol. 3, p. 70)

55. In 1992 "Style & Smile's" sales increased by 70 or 80 million dollars, but purchases from "GG-USA" decreased. (Tr. vol. 3, p. 72)

56. "Style & Smile" is totally autonomous from "GG-USA" in its operations and there is no pressure placed on "Style & Smile" to make purchases from "GG-USA". (Tr. vol. 1, p. 149; Tr. vol. 3, p. 72)

57. California determined that "GG" and its subsidiaries belonged in two unitary groups. One group consisting of "Style & Smile" and its subsidiaries and the other consisting of "GG" and its other subsidiaries. (Tr. vol. 2, pp. 120-122)

CONCLUSIONS OF LAW:

The issue here is whether "Style & Smile" Beauty Supply Co. ("Style & Smile") and its subsidiaries are a separate unitary group or are properly included in the "GG Inc." ("GG" or "taxpayer"), unitary group. This matter comes before this tribunal as a result of the Department's denial of taxpayer's claims for refund wherein it filed amended returns as two unitary groups.⁷ At the same time, the Department issued a Notice of Deficiency that included "BIU" as part of the "GG" unitary group and also made other adjustments that were not protested and are not at issue here.

Taxpayer is a manufacturer of health, beauty, household and food products. During the tax years at issue taxpayer owned 100 percent of the stock of the following companies: "GG USA, Inc." ("GG-USA"), "Powder-Puff Services" ("Powder-Puff"), "GG International, Inc."

⁷ In the amended returns filed by taxpayer, "BIU" was included in the "Style & Smile" unitary group. At hearing, taxpayer conceded that "BIU" was properly included in the group.

("International"), "Style & Smile" Beauty Company, Inc. ("Style & Smile"), "Care-a-Lot Beauty Supply, Inc." ("CAL"), "Johnny Velour Beauty Systems, Inc." ("Johnny V."), and "Beauty Under Pressure Knows Infinite Serenity Co." ("BIU"), all of which are subject to tax in Illinois.

Taxpayer asserts that "Style & Smile" and its subsidiaries are not properly includable in the "GG" group because "Style & Smile" is a retailer and operates a discrete business enterprise from "GG".

The statutory definition of a unitary group is found in Section 1501(a)(27) of the Illinois Income Tax Act. Section 1501(a)(27) provides in pertinent part:

The term "unitary business group" means a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other...Unitary business activity can ordinarily be illustrated where the activities of the members are (1) in the same general line (such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance); or (2) are steps in a vertically structured enterprise or process...; and, in either instance, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member).

It is undisputed that the companies at issue here are not in the same general line of business. "GG" companies are manufacturers and "Style & Smile" companies are retailers. What is at issue is the Department's characterization that there is vertical integration between "Style & Smile" and "GG" and that the companies are functionally integrated through the exercise of strong centralized management.

The record shows that 3 percent of "GG's" sales are made to "Style & Smile", and 3 percent of "Style & Smile's" sales consist of "GG's" products. Neither company depends upon the other either for its source of product nor as its sales outlet. "Style & Smile's" primary

suppliers are "Younger You Corp.", "Nip & Tuck Co.", "Sell-U-Lite, Inc.", "Lushious Lipps", and "Blow-Dry". Of the four thousand plus products "Style & Smile" sells, only 40 to 50 are manufactured by "GG". "GG's" primary customers, on the other hand, are the mass merchandisers such as Wal-Mart, K-Mart and Target. The testimony by both the president of "Style & Smile", "Chuck Baree", and the Executive Vice President of "GG", "Abby Rohd", was that each company could survive without the other's products or sales outlets. (Tr. vol. 1, p. 191; Tr. vol. 3, p. 71) Thus, while there is a fit between the products manufactured by the parent and the products sold by the subsidiary, the impact on the other's business is de minimis.

According to §1501(a)(27), unitary business activity can ordinarily be illustrated where the activities of the members are in the same general line or vertically integrated. The statute, therefore, has left open the possibility that a unitary business may be one where the companies are neither in the same line of business nor vertically integrated. In any case, however, in order for there to be a unitary relationship, the members must be functionally integrated through the exercise of strong centralized management.

There is no bright line test as to what characteristics make a unitary group, but it is clear that it must be more than mere common ownership. In order to find that a unitary business relationship exists, it is necessary to consider the whole of the business enterprise. The statute requires functional integration through strong centralized management, and functional integration is demonstrated "where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital improvement is not left to each member." 35 ILCS 5/1501(a)(27). While the Department has shown elements of centralized management, there has been no showing of either strong centralized management or functional integration.

"Style & Smile" is not dependent upon "GG" for the majority of corporate services. "Style & Smile" has its own finance department, accounting department, legal department, personnel department, distribution department, real estate department, loss prevention department, advertising department, MIS department, internal audit staff, tax department, training department and insurance department.

According to the court in A.B. Dick v. McGaw, 287 Ill. App. 3d 230 (4th Dist. 1997), the flow of value between companies must be significant, that is, it must be more than de minimis. "The justification for combined reporting is that there are 'many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.' [Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 164-165 (1983); Citizens Utilities Co. v. Department of Revenue, 111 Ill.2d 32, 49 (1986)] It would be impossible to provide exact proof of 'largely unquantifiable transfers of value.'" 287 Ill. App. 3d at 239.

The "largely unquantifiable transfers of value" referred to in A.B. Dick result when there is strong centralized management. In this case, there is no evidence of strong centralized management, but, rather, "Style & Smile" is run as an autonomous company by "Chuck Baree", its president. The testimony is that he is an entrepreneur who runs "Style & Smile" as his own company with little input from the corporate parent. Both Mr. "Baree" and Ms. "Rohd", Executive Vice President of "GG" and daughter of the founders, testified to this effect, and I found this testimony credible.

"Style & Smile" creates its own budgets and develops its own strategic plan. "Style & Smile's" real estate department selects sites for new stores, negotiates the leases, all without approval from "GG". During 1991 and 1992, "Style & Smile" opened 200 new stores at a cost of approximately \$20,000,000 without the necessity of acquiring the approval of the parent.

Further, these decisions are made by "Style & Smile's" senior management, "Baree", "Gordon" and "McAllister". "GG" officers are not involved in the process. Nor was "Sue Preems", the Chairman of the Board of "Style & Smile" consulted. "GG" let "Style & Smile's" senior management run "Style & Smile" without interference from corporate headquarters.

"Style & Smile" also finances its capital expenditures internally. It is not necessary for "Style & Smile" to borrow funds from the parent for opening new stores. The only instance of "Style & Smile" borrowing from "GG" was for the acquisition of "Grey B. Gone" Beauty Supply in 1988. This one instance, which is outside of the audit period, is not sufficient to show dependence.

The evidence adduced at hearing shows that these companies operate as independently from each other as commonly-owned companies can. In order to find that companies are members of a unitary group, there must be more than common ownership. The fact that a holding company owns controlling interest in several corporations is not enough to make the group a unitary business. 35 ILCS 5/1501(a)(27). *See also, Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 440 (1980). Here, the characteristics that the Department points to, where "GG" does provide corporate services or oversight to "Style & Smile", are merely the indicia of common ownership. Financial reports are provided to the parent company so that consolidated financial reports can be issued as required generally accepted accounting principles. Consolidated federal tax returns which are filed by the parent company are required of companies with common ownership by the Internal Revenue Service. I.R.C. Section 1501. The legal expenses billed back to "Style & Smile" were as a result of "GG" being named in lawsuits involving "Style & Smile". Insurance expenses relate to billing by a common plan administrator

to the parent company for administration of "Style & Smile's" separate insurance plan, not for services provided by "GG".

"Style & Smile" operates independently as to the day-to-day operations of the company. "GG" management is not involved in major policy issues. "Style & Smile" decides where and when to open stores, "Style & Smile" develops its own strategic plan. Common officers are merely figureheads. "Style & Smile" did not receive capital infusions from "GG", but internally financed the acquisitions of its various store locations. "Style & Smile" maintains its own cash management system, as does "GG". The cash from "Style & Smile's" operations remains in "Style & Smile's" accounts for its own purposes. Neither company has access to the other's data processing system. With several minor exceptions, "Style & Smile" has its own corporate departments that provide services to "Style & Smile" and its subsidiaries. The integration here is the "type of occasional oversight – with respect to capital structure, major debt, and dividends – that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of the management of these...corporations." F.W. Woolworth Co. v. Taxation and Revenue Department, 458 U.S. 354, 369 (1982) (Woolworth was found not to be unitary with its foreign subsidiaries).

The Illinois Appellate Court in Borden, Inc. v. Department of Revenue, 295 Ill. App. 3d 1001 (1st Dist. 1998) found that the exercise of strong centralized management shows that functional integration exists. The Court stated:

In A.B. Dick, this court rejected the notion that functional integration is a separate concept from centralized management and held that "whenever there is functional integration of operations there is also strong centralized management and vice versa." A.B. Dick, 287 Ill. App. 3d at 233...If one or the other has been shown, then there is a unitary business...The stipulated facts here demonstrate a strong centralized management and, accordingly, that functional integration has occurred. That the Director also stated that Borden could exert great influence over the Pepsi Subs does not detract from the substance of the decision. In any

event, the issue of whether the parent possessed the potential for control has been found relevant to, although not dispositive of, the existence of a unitary business. See Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983). 295 Ill. App. 3d at 1009.

I find that taxpayer has introduced credible evidence showing that there was not strong centralized management between "GG" and "Style & Smile", and therefore, has successfully rebutted the Department's prima facie case. Accordingly, for the tax periods ending September 30, 1991 and September 30, 1992, there should be two unitary groups: the "GG" group consisting of "GG, Inc.", "GG-USA, Inc.", "Powder-Puff Services", "GG International, Inc." and "BIU", and the "Style & Smile" group consisting of "Style & Smile Beauty Company, Inc.," "Care-a-Lot Beauty Supply, Inc". and "Johnny Velour Beauty Systems, Inc."

WHEREFORE, for the reasons stated above, it is my recommendation that the taxpayer's claims for refund be granted with the following modifications:--

- 1) "BIU" should be included in the "GG" unitary group.
- 2) The other, non-protested, items contained in the Notice of Deficiency shall be included in recalculating taxpayer's claims.

Date: 4/19/99

Linda K. Brongel
Administrative Law Judge